IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PROGRESSIVE CASUALTY INSURANCE CO.,	:	**CIVIL ACTION**
Plaintiff,	:	
v.	:	
PNC BANK, N.A.,	:	
Defendant.	:	
	:	**NO. 98-6840**

M E M O R A N D U M

Reed, S.J. **July 26, 1999**

Presently before the Court is the motion of the defendant PNC Bank, N.A. ("PNC") (Document No. 9) to dismiss Counts II and III of the plaintiff's Amended Complaint (Document No. 7) pursuant to Federal Rule of Civil Procedure 12(b)(6), and the response of the plaintiff, Progressive Casualty Insurance Co. ("Progressive"), assignee of Madison Bank ("Madison"), thereto (Document No. 12). Jurisdiction is proper pursuant to 28 U.S.C. § 1332. Based on the following analysis, Count II of the plaintiff's amended complaint will be dismissed without prejudice and the defendant's motion to dismiss Count III will be denied.

I. Background

The plaintiff, Progressive Casualty Insurance Company, is a corporation organized and existing under the laws of Ohio, with its principal place of business located in Ohio. The defendant, PNC, is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, with its principal place of business located in Pennsylvania.

On or about May 30, 1997, Madison issued Cashier's Check No. 21506 in the amount of $168,000 to "Fred Beard, Jr., Deanne Beard and Preferred Abstract Inc." (Amended Complaint ¶6). The check was issued by Madison for the purpose of making a mortgage loan to the Beards. Id. On or about May 30, 1997 Madison sent the check to Preferred Abstract. (Amended Complaint ¶8). The proceeds of the check, which purportedly contained the endorsements of the Beards, were intended to fund the Beard's mortgage loan, which was to be closed by Preferred. (Amended Complaint ¶9). Preferred deposited the check for collection in its escrow account at PNC.[1] Id.

PNC cleared the check through the Federal Reserve System, and the check was presented to Madison for payment. (Amended Complaint ¶11). When Madison initially received the check for payment, it refused payment because the endorsement of Preferred was missing. (Amended Complaint ¶12). Madison then returned the check, unpaid, to PNC. Upon return of the check from Madison, PNC purported to supply the missing endorsement of its customer, Preferred, and again presented the check to Madison for payment. (Amended Complaint ¶13). Thereupon PNC placed the funds into Preferred's account, and again presented the check for clearance and payment in the Federal Reserve System. (Amended Complaint ¶14). Based upon PNC's acceptance and deposit of the check, the full amount of the check, $168, 000, was charged to Madison's account. (Amended Complaint ¶15).

After having accepted and deposited the check, PNC allowed the withdrawal of all of the escrowed funds from the escrow account. (Amended Complaint ¶16). Progressive argues that allowing the withdrawal of all of the funds constitutes an unusual disbursement pattern for an escrow account. On or about August 20, 1997, the Beards submitted affidavits, asserting that the

[1] There is a dispute as to whether the check was deposited into an escrow account. See *Infra* notes 4 and 5.

check contained the unauthorized, forged endorsements of each of them. (Amended Complaint ¶18). PNC refused to repay the amount of the check to Madison, and thus Madison sustained a loss in the amount of the check, together with interest from May 30, 1997.[2] (Amended Complaint ¶20).

Madison assigned its rights against PNC and others to Progressive, for proper consideration, to the extent of $144,951. (Amended Complaint ¶21). Based upon the assignment, Progressive is the real party in interest in connection with its claims against PNC.

II. The Arguments of the Defendant

PNC argues that Progressive did not plead facts sufficient to state claims for notice of breach of fiduciary duty under §§ 3-306 and 3-307 of the Pennsylvania Commercial Code, 13 Pa. C.S.A. §1-101 et. seq. (Count II) and negligence (Count III) under which relief could be granted.

PNC first attacks Progressive's claim of notice of breach of fiduciary duty, arguing that, as a "holder in due course" under 13 Pa. C.S.A. § 3-302, it deposited the check forged by Preferred free of all the plaintiff's claims. Specifically, PNC argues that it deposited the check as a holder in due course free of all claims, including the claim of Progressive that Preferred breached a fiduciary duty to Madison.

Second, PNC argues that the negligence claim of Progressive should be dismissed, because the Pennsylvania Commercial Code, like the Uniform Commercial Code, displaces common law negligence causes of action.

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[2] It is not clear from the plaintiff's complaint what conduct of PNC is alleged to have actually caused the loss. I assume, therefore, that the plaintiff's position is that PNC's handling of the forged check and the account caused the loss. (Complaint ¶39).

III. Standard for a Motion to Dismiss

Rule 12(b) of the Federal Rules of Civil Procedure provides that "the following defenses may at the option of the pleader be made by motion: (6) failure to state a claim upon which relief can be granted." In deciding a motion to dismiss under Rule 12(b)(6), a court must take all well pleaded facts in the complaint as true and view them in the light most favorable to the plaintiff. See Jenkins v. McKeithen, 395 U.S. 411, 421 (1969).

Generally, the Federal Rules of Civil Procedure hold claims to the standard of notice pleading. See Fed. R. Civ. P. 8(a) (stating that pleadings should contain "a short and plain statement of the claim showing that the pleader is entitled to relief"). A motion to dismiss the complaint for insufficiency of the pleadings should be denied "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Conley v. Gibson, 355 U.S. 41, 45-46 (1957); see also Hishon v. King & Spaulding, 467 U.S. 69, 73 (1984).

IV. Discussion

The parties both rely on Pennsylvania law in their arguments, and the Court sees no reason why Pennsylvania law should not apply. Every holder of a negotiable instrument is deemed prima facie to be a holder in due course. See 13 Pa. C.S.A. § 3-302; see also Bogdanoff, to Use of Grossman v. Manis, 30 A.2d 321, 322 (Pa. 1943). A holder enjoys a rebuttable presumption that he is a holder in due course. See Cairns v. Reneisen, Reneisen & Redfield, 1988 WL 3094, at *1 (E.D. Pa. Jan. 14, 1988). A holder of an instrument is a holder in due course if:

(1) The instrument when issued or negotiated to the holder does not bear such apparent

> evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument: (i) for value; (ii) in good faith; (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series; (iv) without notice that the instrument contains an unauthorized signature or has been altered; (v) without notice of any claim to the instrument described in section 3306 (relating to claims to an instrument); and (vi) without notice that any party has a defense or claim in recoupment described in section 3-305(a) (relating to defenses and claims in recoupment).

13 Pa. C.S.A. § 3-302(a)(2). Section 3-306, relevant to § 3-302(2)(v) above, and relating to claims to an instrument, provides as follows: "A person taking the instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. . . ." 13 Pa. C.S.A. § 3-306. The application of § 3-306 must be read in conjunction with the notice provisions of § 3-307, which specify when the taker of an instrument has notice of a breach of a fiduciary duty, thus preventing one from asserting a "holder in due course" defense. See 13 Pa. C.S.A. § 3-307 cmt. 2. Section 3-307(b)(2)(iii) provides as follows:

> (b) General Rule – If an instrument is taken from a fiduciary for payment or collection or for value, the taker has knowledge of the fiduciary status of the fiduciary and the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:
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> (2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is:
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> (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

13 Pa. C.S.A. § 3-307(b)(2)(iii).[3] Section 3-307 applies only if the person dealing with the fiduciary "has

[3] A "fiduciary" is an "agent, trustee, partner, corporate officer, or director, or other representative owing a fiduciary duty with respect to an instrument." A "represented person" is the "principal, beneficiary, partnership, corporation or other person to whom the duty stated under the definition of fiduciary is owed." 13 Pa. C.S.A. § 3-307(a).

knowledge of the fiduciary status of the fiduciary." Notice which does not amount to knowledge of fiduciary status is not sufficient to cause § 3-307 to apply. 13 Pa. C.S.A. § 3-307 cmt. 2.[4] Furthermore, paragraph (2) of § 3-307(b), which applies to instruments payable to the represented person or the fiduciary as such, requires that the person have knowledge of facts that constitute a breach of fiduciary duty. Id. Where the instrument is payable to the represented person or the fiduciary as such and taken for deposit to an account, notice of a breach of a fiduciary duty is established if the taker had knowledge that the deposit was made to a personal account of the fiduciary or to an account other than that of the fiduciary as such or an account of the represented person. Id. In such a case, the deposit constitutes notice of a breach of a fiduciary duty, precluding the taker from asserting a holder in due course defense.

A. Count II: Notice of Breach of Fiduciary Duty

I conclude that the allegations contained in Count II of Progressive's complaint are insufficient to state a claim upon which relief may be granted because it is "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Conley, 335 U.S. at 45-46.

In Count II of the amended complaint, the plaintiff seeks to recover the amount of the forged cashier's check from PNC on the grounds that PNC is not a holder in due course, and thus not free from the plaintiff's claim of notice of breach of a fiduciary duty. (Amended Complaint ¶34). The allegations of the plaintiff's complaint fail to state a claim under which relief can be granted under § 3-

[4] A person has "notice" of a fact when: (1) he has actual knowledge of it; (2) he has received a notice or notification of it; or (3) from all the facts and circumstances known to him at the time in question he has reason to know that it exists. A person "knows" or has knowledge of a fact when he has actual knowledge of it. 13 Pa. C.S.A. § 1-201.

307(b)(2)(iii).

First, the plaintiff alleges that Preferred deposited the check into its own escrow account at PNC, and later withdrew the proceeds until the account was fully dissipated. Thus, the plaintiff concludes that: 1) PNC knew of Preferred's fiduciary status as to Madison, and 2) was placed on notice of Preferred's breach of its fiduciary duty. (Amended Complaint ¶33). The plaintiff, therefore, alleges that PNC knew of Preferred's fiduciary status as to Madison. Thus, the plaintiff's allegations, that PNC knew of Preferred's fiduciary status as to Madison are sufficient to state a claim for which relief might be granted, assuming the sufficiency of the plaintiff's allegations regarding notice of a breach of a fiduciary duty.

The crux of the plaintiff's allegations is that PNC had notice of Preferred's breach of fiduciary duty as to Madison. The plaintiff first attempts to establish that PNC had notice of Preferred's breach of fiduciary duty on the basis that Preferred deposited the check into its own escrow account at PNC, and subsequently withdrew the proceeds of the check over time. In support of this argument, the plaintiff argues that PNC knew that the check was not deposited by Preferred into a fiduciary account as such, and thus was deposited to an account other than an account of the fiduciary as such as specified under § 3-307(b)(2)(iii).[5]

The plaintiff's argument, however, is inconsistent with the plain language of § 3-307(b)(2)(iii), because the plain language of the section refers not to the type of the account, e.g. an escrow account, but to the named holder of an account. Because, as the plaintiff alleges, Preferred deposited the check

[5] In order to make this argument, the plaintiff relies on the defendant's answer to the plaintiff's complaint (Document No. 8) in which the defendant denies that the account to which the deposit was made was an escrow account. (Defendant's Answer ¶9). Picking up on this denial, the plaintiff argues in its response (Document No. 12) to the defendant's motion to dismiss (Document No. 9) that PNC knew that the deposit was not made to a fiduciary account, and thus was made to an account other than an account of the fiduciary as such. Thus, the plaintiff argues that PNC had notice of Preferred's breach of fiduciary duty as to Madison under § 3307(b)(2)(iii).

into its own escrow account (Amended Complaint ¶33), knowledge of the deposit could not provide notice to PNC under § 3-307(b)(2)(iii). Moreover, the rationale behind the notice provisions of § 3-307(b)(2) is that there must be facts on which the taker knows that the deposit is made for the personal benefit of the fiduciary or to pay off a personal obligation or debt of the fiduciary. See 13 Pa. C.S.A. §3-307(b)(2) cmt 2-3. On the facts here, the check was made payable to "Fred Beard, Jr., Deanne Beard and Preferred Abstract, Inc." The check also contained what appeared to be the genuine endorsements of both the Beards and Preferred. The plaintiff does not allege any facts from which to infer that the taker of the check for deposit knew that the deposit was for the personal benefit or to pay off a personal obligation of Preferred. Thus, the plaintiff fails to allege any facts from which to infer that the deposit itself provided notice to PNC of a breach of a fiduciary duty by Preferred as to Madison.

Furthermore, the plaintiff argues, without the support of any authority, that the defendant knew and had notice of Preferred's breach of fiduciary duty as to Madison because of the "unusual disbursement pattern" followed with respect to the account, the amount of the check, as well as from PNC's own experience as a mortgage lender. (Response to Defendant's motion to dismiss at 7-8). The facts which support the plaintiff's argument are not sufficient to constitute notice under the explicit provisions of § 3-307(b)(2).

The plaintiff's argument, however, raises the issue of whether the provisions of § 3-307(b)(2) are exhaustive of the circumstances which might constitute notice, since a person may have notice of a fact when "from all the facts and circumstances known to him at the time in question he has reason to know that it exists." 13 Pa. C.S.A. § 1-201. The gist of the plaintiff's argument is that because of their experience in the mortgage lending business, the defendants knew of the unusual disbursement pattern

that followed with respect to the account, and that such knowledge constitutes sufficient notice, even if the facts alleged by the plaintiff do not constitute notice under the explicit provisions of § 3307(b)(2)(iii). There is, however, a problem with this argument because notice received by an organization is effective for a particular transaction only "from the time it is brought to the attention of the individual conducting that transaction, and in any event from the time it would have been brought to his attention if the organization had exercised due diligence."[6] 13 Pa. C.S.A. § 1-201. The key to the plaintiff's argument is that there was an unusual disbursement pattern followed with respect to the account. But a "disbursement pattern" is not the type of fact which can be brought to the attention of the individual conducting the transaction, because by its nature a pattern occurs only subsequent to the transaction. Therefore, the plaintiff's argument that PNC, because of its experience in the mortgage lending business, had knowledge of the unusual disbursement pattern that followed with respect to the escrow account, and thus had notice of Preferred's breach of fiduciary duty as to Madison under § 3-307, is not sufficient to state a claim under which relief can be granted under rule 12(b)(6).

Second, the plaintiff alleges that because (1) the check contained unauthorized and forged

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[6] A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when:

(1) it comes to his attention; or

(2) it is duly delivered at the place of business through which the contract was made or at any other place held by him as the place for receipt of such communications.

Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information. 13 Pa. C.S.A. § 1-201.

To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it. 13 Pa. C.S.A. § 3-302(f).

signatures, and (2) was accepted for deposit by PNC, PNC thus had notice of a breach of fiduciary duty by Preferred, preventing PNC from asserting a holder in due course defense; and thus, the plaintiff alleges that it is entitled to rescind the negotiation of the check and its proceeds. (Amended Complaint § 36). The plaintiff's allegation as stated, however, overlooks the fact that there is no language in § 3-307 which provides that the acceptance of a forged instrument by itself constitutes notice of a breach of a fiduciary duty. Thus, the most fruitful interpretation of the plaintiff's allegation is that PNC, by accepting a check containing forged and unauthorized signatures, is precluded from asserting a holder in due course defense under § 3-302, and thus is subject to the plaintiff's claim to rescind the negotiation and to recover the instrument or its proceeds.

The plaintiff states that the check contained an unauthorized and forged signature. Under § 3-302(2)(iv), the taker must take the instrument without notice that the instrument contains an unauthorized signature or has been altered.[7] 13 Pa. C.S.A. 3-302(2)(iv). A person has notice of a fact, when from the facts and circumstances known to them at the time, they have reason to know that it exists. See Federal Deposit Ins. Corp. v. Barness, 484 F. Supp. 1134, 1145 fn. 9 (E.D. Pa. 1990). The plaintiff, however, merely asserts that the check contained an unauthorized and forged signature without alleging any facts or circumstances from which to infer that the defendant had notice of an unauthorized and forged signature. The plaintiff's argument, therefore, is insufficient to rebut the presumption that

[7] Section 3-302, discussed above, has two parts: 3-302(1) and 3-302(2) each of which deals with forgery but in apparently different ways. Under § 3-302(1), a holder in due course means the holder of an instrument if "the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity." 13 Pa. C.S.A. § 3-302(1). The plaintiff alleges no circumstances from which to infer the apparent forgery, irregularity, or incompleteness of the instrument sufficient to doubt the instrument's authenticity under § 3-302(1). Thus, the plaintiff argues that the defendant cannot satisfy the second prong of 3-302. Specifically, the plaintiff alleges that the instrument contained an unauthorized and forged signature, and thus prevents the defendant from asserting a holder in due course defense.

the defendant is a holder in due course, and thus is insufficient to state a claim entitling the plaintiff to rescind the negotiation of the instrument and to recover the instrument or its proceeds.

On the basis of the above analysis, I conclude that the allegations of the plaintiff's Amended Complaint in Count II for breach of notice of fiduciary duty are insufficient to state a cause of action, and thus Count II will be dismissed without prejudice to the right of the plaintiff to amend those parts of its complaint to state a claim under § 3307, to the extent that the facts, law, and Rule 11 allow, consistent with this Memorandum.

B. Count III: Common Law Negligence

In Count III of its Amended Complaint, the plaintiff alleges that PNC owed Madison a duty to conduct its business affairs in a manner free from negligence and in accordance with reasonable commercial standards of fair dealing. (Amended Complaint ¶¶37-39). Specifically, the plaintiff alleges that the defendant was careless and negligent in its handling of the account and the check. (Amended Complaint ¶39) I conclude that the allegations of the plaintiff's complaint in Count III are sufficient to state a claim upon which relief may be granted as it is not beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle it to relief.

In its response to the defendant's motion to dismiss, the plaintiff first argues that the UCC and the Pennsylvania Commercial Code do not "displace" common law causes of action for negligence, as the defendant argues, but that negligence claims under the UCC are "statutory in nature" rather than common law claims. (Response to Defendant's Motion to Dismiss at 7-8). While the plaintiff's argument in support of this position is not clear, its complaint successfully states a claim upon which relief might be granted, and thus survives the assertions of the defendant.

Section 1-103 of the Pennsylvania Commercial Code provides: "Unless displaced by the particular provisions of this title, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." 13 Pa. C.S.A. § 1-103.[8] Furthermore, the common law of Pennsylvania is retained by commercial code as authoritative where not expressly superseded by it. Carpel v. Saget Studios, Inc., 326 F. Supp. 1331, 1333 (E.D. Pa. 1971).

The Court of Appeals for the Third Circuit has held that the UCC does not displace common law negligence causes of action. In New Jersey Bank, N.A. v. Bradford Securities Operations Inc., in which a bank brought an action against a securities brokerage for damages sustained when a bank customer defaulted on a loan secured by securities which had been stolen by the brokerage and forged, the principal question was whether the district court's acceptance of a UCC defense under Article 8 (dealing with investment securities) precluded the assertion of a common law negligence claim. See New Jersey Bank v. Bradford Securities Operations Inc., 690 F.2d 339, 340, (3d Cir. 1982). Recognizing the underlying issue as involving the status of parallel common-law remedies for violations which were already redressable under the Code, the court held, in the absence of any other decision addressing the precise issue, that the UCC does not preclude a common-law remedy in tort for violations which are also redressable under the UCC. Id. at 345.[9] The court reasoned that where the

[8] This provision of the Pennsylvania Commercial Code is similar to § 1-101 of the UCC.

[9] In reaching this conclusion, the court began with two propositions. First, the UCC is to be "liberally construed and applied" in order to promote its underlying purposes and policies, which include "simplifying and clarifying the law governing commercial transactions, fostering the expansion of commercial practices, and standardizing the laws of the various jurisdictions." 690 F.2d 339, 345. Second, "the UCC does not purport to preempt the entire body of law affecting the rights and obligations of parties to a commercial transaction." Id. Consistent with these two principles of construction, the court reasoned that recognizing a tort remedy furthered the policy of Article 8, as it promotes the negotiability of securities by placing the risk of loss on the party most able to

Code affords a comprehensive remedy for parties to a transaction, a common law action is barred. Id. at 346. Moreover, the court reasoned that providing for a remedy in tort furthers the policy of Article 8 because it "promotes the negotiability of securities by placing the risk of loss on the party most able to minimize that risk." Id. at 347. In Yahn & McDonnell, Inc. v. Farmers Bank of Delaware, in which the plaintiff alleged that the bank wrongfully dishonored its certificate of deposit, the Court of Appeals for the Third Circuit, following the reasoning of the court in New Jersey Bank, held that the UCC does not bar a claim based on a theory of negligence.[10] See Yahn & McDonnell, Inc. v. Farmers Bank of Delaware, 708 F.2d 104, 113 (3d Cir. 1983).

Based on the reasoning of the above cases, it is necessary to determine (1) whether the Code provides a comprehensive remedial scheme for the parties to the transaction, and (2) whether the policy of the Code is furthered by placing the risk of loss on the party most able to minimize that risk.[11] On the facts of this case, neither New Jersey Bank nor Yahn are helpful for the purpose of determining whether

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minimize that risk. Id. at 347.

[10] Delaware adopted the Uniform Commercial Code. See Yahn 708 F.2d at 106 fn. 3.

[11] It is not clear from the language of the opinions in New Jersey Bank and Yahn precisely how this analysis is supposed to work. For example, the Yahn court stated that the New Jersey Bank court "concluded that where the Code provides a comprehensive remedy for parties to a transaction, a common law action is barred. But a remedy in tort will be recognized where the Code's policy is furthered by 'placing the risk of loss on the party most able to minimize that risk.'" It is not exactly clear, then, according to this language, what is required in a case where the remedy is not comprehensive, but where allowing a remedy in tort would promote the policy of the Code. In other words, it is not clear whether an action at common law is absolutely precluded if the remedy provided for under the Code is comprehensive. The court in New Jersey Bank first determined that Article 8 did not provide a comprehensive remedy, and then stated that allowing an action at common law furthered the policy of the Code. 690 F.2d at 347. The Yahn court, however, began its analysis by stating that the circumstances of that case fell within that category of cases where allowing an action in negligence at common law would be consistent with the Code's policy of placing the risk of loss on the party most able to minimize that risk. 708 F.2d at 113. The court then merely added that the remedial scheme provided for under the holder in due course doctrine was not comprehensive enough to supplant a negligence action. Id. Thus, it is still unclear whether an action at common law is absolutely precluded if the remedy is not comprehensive, but where allowing such a remedy would further the policy of the Code by placing the risk of loss on the party most able to minimize that risk. For the sake of my discussion here, I will analyze both issues.

the UCC provides a comprehensive remedy, or whether allowing an action in negligence is consistent with the policy of the Code by placing the risk of loss on the party most able to minimize that risk.[12]

The most prominent sections in the UCC dealing with negligence are § 3-406 and § 4-406.[13] The former concerns negligence contributing to a forged signature or alteration of an instrument. The latter provision concerns the duty of a customer to discover and report unauthorized signatures or alterations. These provisions, however, "function within the check collection liability scheme mostly as an estoppel." JAMES WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 16-6, at 805 (3d ed. 1988).

But in at least one case, Article 4 recognizes negligence as the basis for an "affirmative cause of action," namely in § 4-202, which provides that a "collecting bank" must use ordinary care.[14] Id.

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[12] New Jersey Bank dealt specifically with Article 8 of the UCC which concerns Investment Securities. In Yahn, the court concluded that, because "an action in negligence is separate and distinct from any claim based on the instrument or the underlying contract, we do not believe that the allocation of rights created by the holder in due course doctrine presents such a comprehensive remedial scheme as to supplant a negligence action." 708 F.2d 104,113. However, in Yahn the plaintiff was asserting rights as a holder in due course, and not, as here, the defendants, who employ the doctrine as an affirmative defense. Thus, the Yahn court's conclusion that the holder in due course doctrine does not provide a comprehensive remedy is inapplicable to the circumstances alleged here.

[13] The Pennsylvania Commercial Code adopts provisions similar to the UCC. See 13 Pa. C.S.A. §3-406 and § 4-406.

[14] The plaintiff does not allege a violation of section 4-202 specifically. Thus, my analysis here is relevant only to the issue of whether Articles 3 and 4 of the Code provide for a comprehensive remedy. Section 4-202 of the Pennsylvania Commercial Code provides:

(a) When collecting bank must use ordinary care. – a collecting bank must use ordinary care in:
(1) presenting an item or sending it for presentment;
(2) sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the transferor of the bank after learning that the item has not been paid or accepted, as the case may be;
(3) settling for an item when the bank receives final settlement; and
(4) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(b) Exercise of ordinary care – A collecting bank exercises ordinary care under subsection (a) by taking proper action before its midnight deadline following receipt of an item, notice or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(c) Non-liability of bank for the action of others – Subject to subsection (a)(1), a bank is not liable for the insolvency, neglect, misconduct, or default of another bank or person or for loss or destruction of an item in

Moreover, "surely an implication of 4-103(5) on damages is that there is an affirmative cause of action against a collecting bank for failure to use reasonable care."[15] Id. White and Summers, however, note that while there are cases "where it is appropriate for the court to allocate losses by use of a negligence action. . .we hope the courts will be cautious. . .[W]hen one thinks he has found a large hole in the scheme, he is likely to be mistaken." Id. The reason they advise caution on the part of the courts is that the scheme of loss allocation provided for by Articles 3 and 4 while not comprehensive, "is nearly so." Id. at 806. Nevertheless, because the remedy provided for under Articles 3 and 4 is not comprehensive, according to the reasoning in New Jersey Bank and Yahn, a common law action in negligence will not be barred here.

Having determined that the remedial scheme of Articles 3 and 4 is not comprehensive, it is necessary to determine whether a remedy in tort will further the policy of the Code by placing the risk of loss on the party most able to minimize that risk. The plaintiff alleges that the defendant was negligent in its handling of the account and the check, in order to recover the amount of the fraudulently indorsed check. Under the provisions of the UCC, "the risk of forged indorsements. . .is usually on the shoulders of the immediate transferee from the forger." BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS, ¶ 12.01 at 12-3 (rev. ed. 1999). In such cases, therefore, whatever route is chosen for the recovery of the proceeds of the check, i.e. suit by the

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the possession of others or in transit.

13 Pa. C.S.A. § 4-202.

A collecting bank is any bank handling an item for collection except the payor bank. 13 Pa. C.S.A. § 4-105. A payor bank is a bank by which an item is payable as drawn or accepted which inlcudes the drawee of the check. 13 Pa. C.S.A. § 4-105. Here, because the check is a cashier's check, Madion is both the drawee and the drawer.

[15] Section 4103(e) of the Pennsylvania Commercial Code provides that "the measure of damages for the failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. If there is also bad faith it includes any other damages the party suffered as a proximate consequence." 13 Pa. C.S.A. § 4-103(e). This provision is similar to UCC § 4-103(5).

intended payee or the drawer, "the loss is likely to land ultimately on the depositary bank as transferee from the malefactor and the party in the best position to avoid the loss." Id. The general policy of the Code, therefore, is to allocate the risk of loss to the depositary bank in cases involving forged instruments. See id. Given the similarity of the provisions in Articles 3 and 4 of the Pennsylvania Commercial Code to those in the UCC, it is reasonable to assume that the policy of the Pennsylvania Commercial Code is similar to the policy of the UCC. Thus, the plaintiff will be permitted to state a cause of action in negligence, because doing so will have the effect of allocating the risk of loss to the depositary bank, PNC.

In order to support their argument that the Code precludes a common law negligence claim, the defendants cite Universal Premium v. York Bank & Trust Co. in which the court stated that, in the absence of a Pennsylvania appellate court decision, they would assume without deciding that § 3-405 of the Pennsylvania Code, concerning an employer's responsibility for fraudulent indorsement by an employee, would preclude common law negligence actions. Universal Premium v. York Bank & Trust Co., 69 F.3d 695, 704 (3d Cir. 1995). But the defendants overlook the fact that the court stated further that where section 3-405 does not apply, a party is free to bring a negligence action. See id. Because § 3-405 does not apply in the present case, the plaintiff's are free to bring a common law claim for negligence.

Lastly, the defendants argue that Pennsylvania law does not impose an independent duty on a bank to someone other than its customer, and thus banks do not owe a duty to third parties who are not parties to the deposit agreement. (Motion to Dismiss at 13). The defendants cite section 4-401 of the Pennsylvania Commercial Code in support of this argument. Section 4-401, however, concerning when a bank may charge the account of a customer, is silent on the scope of a bank's liabilities to third

parties. See 13 Pa. C.S.A. § 4-401. The defendants also cite Roy Supply v. Wells Fargo Bank as holding that a bank is liable only to its customer for the mishandling of that customer's account. See Roy Supply v. Wells Fargo Bank, 46 Cal. Rptr.2d 309, 311 (Cal. App.3d Dist. 1995). The defendants, however, misstate the holding of the case; the court held not that the bank is liable only to its customer but that the plaintiff, Roy, had no individual cause of action in negligence against the bank because the bank had no commercial relationship with Roy with respect to the accounts at issue. Id. at 311. The problem with the defendant's arguments is that they assume that because a contract provides the basis for a duty between a bank and its customer that the contract between a bank and its customer is the only source of a bank's duty. The defendant cites no authority to support this assumption.

On the basis of the above analysis, the allegations in Count III of the plaintiff's complaint, that PNC breached a duty to Plaintiff to conduct its business affairs free from negligence and in accordance with reasonable commercial standards state a cognizable cause of action.

IV. Conclusion

Based on the foregoing, Count II of the plaintiff's amended complaint will be dismissed without prejudice, with permission to replead, and the defendant's motion to dismiss Count III will be denied. An appropriate Order follows.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PROGRESSIVE CASUALTY INSURANCE CO.,	:	**CIVIL ACTION**
Plaintiff,	:	
v.	:	
PNC BANK, N.A.,	:	
Defendant.	:	
	:	**NO. 98-6840**

O R D E R

AND NOW this 26th day of July, 1999, upon consideration of the motion of defendant PNC Bank, N.A. ("PNC") to dismiss the amended complaint of plaintiff Progressive Casualty Insurance Co. ("Progressive") pursuant to Federal Rule of Civil Procedure 12(b)(6) (Document No. 9), and the response of Progressive (Document No. 12), and based on the foregoing memorandum, it is hereby accordingly **ORDERED** that Count II of the plaintiff's amended complaint is **DISMISSED WITHOUT PREJUDICE**, with permission to replead, and the motion of the defendants to dismiss Count III is **DENIED**.

IT IS FURTHER ORDERED that no later than August 25, 1999, plaintiff may file a second amended complaint re-pleading all counts exactly as plead in the first amended complaint and amending only Count II of the first amended complaint consistent with the terms of this memorandum and order.

IT IS FURTHER ORDERED that the defendant should respond to any amended complaint so filed no later than September 20, 1999. If no second amended complaint is filed, the answer shall nonetheless be filed to the first amended complaint except for Count II by said date.

LOWELL A. REED, JR., S.J.

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